

OFFICIAL FILE  
ILLINOIS COMMERCE COMMISSION

ORIGINAL

STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION

ILLINOIS  
COMMERCE COMMISSION

MAR 23 12 41 PM '01

Illinois Bell Telephone Company )

Application for Review of Alternative )  
Regulation Plan )

Docket No. 98-0252

Petition to Rebalance Illinois Bell )  
Telephone Company's Carrier Access and )  
Network Access Line Rates )

Docket No. 98-0335

Citizens Utility Board and People of the )  
State of Illinois, ex rel. James E. Ryan, )  
Attorney General of the State of Illinois, )  
Complainants )

vs. )

Docket No. 00-0764

Illinois Bell Telephone Company d/b/a )  
Ameritech Illinois, )  
Respondent )

(consolidated)

**INITIAL BRIEF OF THE CITY OF CHICAGO**

(Public Version)

Mara S. Georges  
Corporation Counsel  
Susan J. Herdina  
Deputy Corporation Counsel  
Conrad Reddick  
Special Deputy Corporation Counsel  
Jack A. Pace  
Karen M. Coppa  
Assistant Corporation Counsel

30 N. La Salle Street  
Suite 900  
Chicago, Illinois 60602  
312-744-6997

**Oral Argument Requested**

## TABLE OF CONTENTS

Introduction.....	1
I. Summary Of The City 's Position.....	3
II. Review Of The Alternative Regulations Plan.....	6
A. Scope Of The Review Proceeding.....	6
1. Five Year Experiment.....	6
2. Comprehensive and Detailed Analysis Required With Clearly Defined Standards of Review.....	8
3. Plan Results Must Be Compared To What Would Have Resulted From Rate Of Return Regulation.....	12
B. The Plan Failed To Satisfy Key Public Policy Goals.....	12
1. The Plan Failed To Satisfy The Policy Goal of Promoting Competition.....	13
(a). Promoting Competition Is A Goal Of Alternative Regulation And Is Required By Statute.....	13
(b). The Level of Effective Competition In Illinois Is De Minimis Under The Plan.....	15
(1). CLEC Market Share Remains Marginal.....	15
(2). Ameritech Has Failed to Open Its Network As Shown By Its Inability To Support a Section 271 Application.....	16
(c). The Plan's Incentives Likely Have Hindered The Growth Of Competition .....	17
2. The Plan (And Ameritech's Rebalancing Petition) May Harm The Universal Service Goal Of The Public Utilities Act.....	19
(a). The Plan May Have Harmed The Policy Goal Of Universal Service.....	19

(b).	Ameritech's Rate Rebalancing Proposal Will Likely Further Harm Universal Service In Illinois.....	20
3.	The Plan Has Failed To Satisfy Other Policy Goals Defined by the Act.....	21
C.	The Plan Failed To Satisfy The Section 13-506.1 Statutory Requirements.....	21
1.	The Current Plan Has Produced Inadequate Service Quality.....	23
(a).	OOS > 24 Hours And Installation Within Five Days Are The Most Important Service Quality Standards Of Current Plan.....	25
(b).	Service Quality Performance Has Grown Worse, Not Better Over the Life Of The Plan.....	27
(c).	Ameritech Illinois' Current Plan Permits A Self-Serving Cost-Benefit Analysis And Does Not Support Service Quality.....	30
2.	The Plan Has Produced Unjust and Unreasonable Rates.....	32
(a).	Noncompetitive Rates Set By Price Cap Formula.....	32
(b).	Competitive Rates Also Must Be Just and Reasonable.....	33
(c).	Excessive Earnings Not Caused By Proper Implementation Of Plan.....	35
III.	The City's Going Forward Plan Recommendations.....	37
A.	Earnings Analysis And Rate Reinitialization Is Consistent With The 1994 Order And The Goals Of The Alternative Regulation Plan Adopted By The Commission.....	38
1.	The 1994 Order.....	38
2.	Rate Reinitialization May Be Required By An Earnings Analysis And The Public Utilities Act.....	40
B.	Modifications To The Price Cap Index Must Be Made.....	41
IV.	Service Quality Measures Must Be Expanded And Financial Incentives Increased Under Any Future Plan.....	43

V.	Revenue Requirement Analysis.....	45
A.	The City Recommends That The Commission Reduce Ameritech Illinois' Rates By \$956 Million.....	45
B.	Ameritech's Depreciation Expense Should Be \$382.4 Million For 1999 Test Year Purposes.....	46
1.	The 1999 Test Year Analysis Does Not Challenge The Depreciation Flexibility Granted To Ameritech During The Plan.....	47
2.	The City's Proposed Depreciation Adjustment Is Reasonable.....	48
3.	Ameritech's Improper Amortization Accounts For Most Of The Remaining Depreciation Error.....	49
(a).	There Was No Reserve Deficiency In 1999.....	50
(b).	FAS 71 Amortization.....	51
(1)	FAS 71 Amortization Only Booked By Ameritech On State Regulatory Books.....	51
(2)	FCC Treats A "FAS 71" Amortization As A "Below The Line" Expense.....	52
4.	The City And GCI's Depreciation Rates Are More Reasonable Than Those Used By Ameritech.....	52
(a).	Use of 1999 Data Is More Appropriate.....	53
(b).	More Reasonable Depreciation Parameters Should Be Used.....	53
5.	Ameritech Cannot Reduce Depreciation Reserve For 1999 Test Year.....	54
VI.	Ameritech's Current Rates Exceed The Corrected Cost Of The Residential Network Access Line.....	56
A.	Ameritech Illinois Did Not Use The "Least Cost Currently Available" Technology.....	58
B.	Ameritech Illinois' Cost Model Contains Additional Flaws.....	61

1.	Ameritech Admits Error In Calculating The NAL Field Installation Cost.....	61
2.	Ameritech Improperly Included All of the “Common” Cost Of The Switch In The Alleged “Port” Cost Of The NAL LRSIC.....	62
3.	Ameritech Double Recovered The Costs Of Installing The Network Interface Device (NID).....	62
4.	Mix Of New and Growth Lines Should Be Based On Long Run Approach.....	63
5.	Ameritech Improperly Includes All Of The “Revenue Ready” Fee In The Ameritech NAL LRSIC.....	64
6.	Ameritech Improperly Placed All Of The Payment Processing And Statement Mailing Cost In The NAL LRSIC.....	65
7.	Ameritech Uses An Improper Cost of Capital In Its NAL LRSIC.....	66
8.	Ameritech Improperly Inflates Net Investment Over 50 %.....	66
C.	Ameritech Improperly Argues That The NAL Should Be Increased To Cover Additional Costs.....	68
1.	Ameritech Improperly Adds “Spare Capacity” Cost.....	68
2.	Ameritech’s Allocation Of Advertising And Similar Costs To The Residential NAL Is Arbitrary, Unjust And Unreasonable.....	69
VII.	Rate Design.....	70
A.	Ameritech’s Rate Rebalancing Petition Should Be Denied .....	70
1.	Residential Network Access Line Rates Are Currently Above Cost.....	71
2.	Ameritech’s Proposal Selectively Limits Economic Pricing to the NAL, While Preserving Non-Economic High Levels for Vertical Service and Usage Rates.....	72
3.	Additional Reasons To Reject Ameritech’s Rate Rebalancing Proposal.....	73

(a)	Promotion Of Competition Is Speculative And Should Be Disregarded.....	73
(b).	Correction To Rate Structure Is Premature.....	73
(c).	Ameritech Failed To Demonstrate That The Commission's Rate Increase Moratorium Should Not Be Extended.....	74
(d).	Carrier Access Charges Have Not Been Found To Support Residential NAL.....	74
B.	The City's Rate Design Proposal.....	75
1.	Network Access Lines.....	76
2.	Residential Service Order Charges.....	76
3.	Residential Local Usage.....	76
4.	Business Local Usage.....	77
5.	Residential Vertical Services.....	78
6.	Business Vertical Services.....	78
7.	Residential and Business Directory Listings.....	78
	Conclusion.....	79

STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION

Illinois Bell Telephone Company	)	
	)	
Application for Review of Alternative	)	Docket No. 98-0252
Regulation Plan	)	
	)	
Petition to Rebalance Illinois Bell	)	
Telephone Company's Carrier Access and	)	Docket No. 98-0335
Network Access Line Rates	)	
	)	
Citizens Utility Board and People of the	)	
State of Illinois, ex rel. James E. Ryan,	)	
Attorney General of the State of Illinois,	)	
Complainants	)	
	)	
vs.	)	Docket No. 00-0764
	)	
Illinois Bell Telephone Company d/b/a	)	
Ameritech Illinois,	)	(consolidated)
Respondent	)	

**INITIAL BRIEF OF THE CITY OF CHICAGO**

Now comes the City of Chicago ("City"), by its attorney, Mara S. Georges, Corporation Counsel, pursuant to Section 200.800 of the Illinois Commerce Commission's ("Commission") Rules of Practice, 83 Illinois Administrative Code, Subchapter b, Part 200.800, and by direction of the Hearing Examiners, hereby files its initial brief in this matter.

**INTRODUCTION**

This proceeding is a consolidation of three dockets.

On March 31, 1998, nearly three years ago, Ameritech Illinois filed its application for review of its alternative regulation plan, which was authorized in *Illinois Bell Telephone Petition*

*to Regulate Rates and Charges of Noncompetitive Services Under an Alternative Form of Regulation*, Order, ICC Docket 92-0448/93-0239(consol.) on October 11, 1994 (hereinafter "1994 Order").

In the 1994 Order, the Commission required Ameritech Illinois to file its application for review some fifteen months prior to the date that the provisions of the Public Utilities Act which authorized alternative regulation were then set to have expired, July 1, 1999. Subsequent to the 1994 Order, the original sunset date of July 1, 1999 was extended to July 1, 2001. Therefore, what was initially intended to be a five year plan has been in full force and effect for nearly six and one-half years. The Commission mandated a review of the alternative regulation so it could evaluate, on the basis of actual results, whether the alternative approach to regulation had worked and whether it should continue, with or without significant modifications, or be terminated.

On April 30, 1998, prior to the end of the first five years of the alternative regulation plan, Ameritech Illinois filed its Petition to Rebalance Illinois Bell Telephone Company's Carrier Access and Network Access Line Rates ("Rebalancing Petition"). Initially, in its Rebalancing Petition, Ameritech Illinois sought Commission modification of the 1994 Order to eliminate the five-year cap on basic residence service rates so that it could increase the residential network access line rates in Access Areas A, B and C. There has been no Commission finding since the 1994 Order that consumers no longer need the protection provided by the rate cap. Ameritech Illinois' claims now that the rate cap has since expired.

Ameritech proposes to increase rates for (essentially monopoly) residential network access lines by \$2 per month in access areas A, B and C, an area that covers most of northern Illinois. If adopted by the Commission, the rate increase would generate \$84.5 million in



additional revenue to Ameritech Illinois. Ameritech is proposing to offset this revenue increase with a series of rate decreases on selected optional noncompetitive services, including Band B usage rates, some optional pay-per-use vertical services, and residential installation charges, among others.

On November 30, 2000, the Citizens Utility Board and the Attorney General of Illinois, pursuant to sections 9-101, 9-250, 13-505 and 13-506.1 of the Illinois Public Utilities Act, filed a Complaint for a Reduction in Illinois Bell Telephone Company's Rates and Other Relief. This complaint requests that the Commission reinitialize or reduce Ameritech Illinois' rates in conjunction with its review of Illinois Bell's alternative regulation plan.

Several parties have actively participated in this proceeding, including the City of Chicago, the Attorney General of Illinois, the Citizens Utility Board, the Cook County State's Attorney's Office, Ameritech Illinois, AT&T, McLeodUSA Telecommunications Services, Inc., the Illinois Cable Television Association, the United States Department of Defense and the Staff of the Illinois Commerce Commission. Hearings were held from February 13, 2001 through February 23, 2001, and the record was marked heard and taken on March 2, 2001.

## **I SUMMARY OF THE CITY'S POSITION**

Ameritech Illinois has failed to demonstrate that the performance of its alternative regulation plan has fulfilled the Commission's expectations and goals in the 1994 Order or satisfied the statutory criteria found in Section 13-506.1, the provision in the Illinois Public Utilities Act that governs the Commission's authority to approve alternative regulation plans. 220 ILCS Section 5/13-506.1.

In the 1994 Order, the Commission found -- on the basis of the information then available

-- that competition was likely to accelerate and that one of the purposes of the alternative regulation plan would be to provide a mechanism for a successful transition to a more competitive environment. 1994 Order, pp.19-20. Accordingly, the Commission found that the Plan would more effectively balance the interests of ratepayers, Ameritech, its shareholders and the overall interests of the people of the State of Illinois because of the changing structure of the local telecommunications market. Id. The record demonstrates that the current Plan has not adequately balanced those interests; it has not provided the desired consumer service, benefits, and protection. The failures stem from deficiencies in the Plan, as well as Ameritech's questionable operations under the Plan.

Ameritech's customers are paying prices determined by the Plan formula, but are not receiving adequate levels of service that the Plan formula anticipated. In fact, the level of service has declined precipitously under the Plan. There is also substantial evidence that Ameritech has abused the service reclassification process. By reclassifying services as competitive that did not meet the statutory criteria, Ameritech could increase rates for services that are actually noncompetitive above the level defined by the Plan index. Consequently, the rates produced under the Plan are not just and reasonable.

The record in this review proceeding has established the following:

- The rate of failure in correcting out of service problems within 24 hours averaged about 14.1% between 1995-1998 (plan years)—over twice the average rate of failure in 1990-1994 (prior to plan years);
- Out of service performance reached 15.2% in August 2000;
- The number of lines that were out of service almost doubled between late 1999 and mid-2000;

- Since early 1999, the average number of days needed to install a new access line (as captured by the POTS Mean Installation Interval measure) has more than doubled for residential customers;
- In 1999, Ameritech achieved a 28.49% earned return on rate base and a 43.08% return on equity (profits);
- After six years of the alternative regulation plan, Ameritech retains control of approximately 93% of the telephone lines while up to fifty nine "competitive" carriers share the remaining number of lines;
- During the alternative regulation plan, Ameritech reclassified over half of its services as competitive, raising the rates of many of these "competitive" services;
- Ameritech Illinois' investment in outside plant per access line dropped from \$35 per access line in 1990-1991(before the plan) to \$19 per access line in 1999 (the fifth year of the plan); and
- Ameritech has not filed a Section 271 application since 1996, acknowledging that it has not opened its network sufficiently for competitors.

The City of Chicago supports the pro-competitive policies of the General Assembly and the Commission. Prudently, the General Assembly has mandated a transition to competition that removes regulation only as effective competition develops. See 220 ILCS 5/13-502. The availability of price constraining market forces is an essential element of the foundation for approval of plans to reduce traditional regulation.

Given the lack of competition in the local service market in Illinois, the Commission must determine expressly whether (on the record) consumers might well be better served by rate-of-return regulation, as opposed to an alternative form of regulation. Under the statutory criteria, traditional regulation would certainly be better than an alternative regulation plan that produces unprecedented low levels of service to consumers at the same time it produces excessive earnings for the company.

Under these circumstances, the City certainly cannot support continuation of the Plan as currently structured. In addition, the City has strong reservations, based on the record evidence, whether alternative regulation under any terms is in the public interest at this time. If the Commission, however, decides that modifications can be made to the alternative regulation plan to satisfy the statutory criteria of the Public Utilities Act, the City contends that this can be accomplished only if the Commission reinitializes rates, increases the X-factor in the price cap index, substantially expands the number of service quality measures and substantially increases the magnitude of the service quality financial incentives.

Ameritech Illinois' proposed modifications to the Plan would, among other things, lessen service quality penalties and allow it to increase noncompetitive rates even faster through "greater pricing flexibility". These modifications should be categorically rejected by the Commission. Similarly, Ameritech Illinois' rate rebalancing petition to increase residential rates by \$84.5 million should be denied. Residential rates are already above cost and raising rates at a time when telephone penetration levels have been declining in Illinois, rather than increasing as in the rest of the country, is not sound public policy.

## **II. REVIEW OF THE ALTERNATIVE REGULATION PLAN**

### **A. SCOPE OF THE REVIEW PROCEEDING**

#### ***1. Five Year Experiment***

In 1994, the Commission implemented Section 13-506.1 of the Public Utilities Act for the first time and authorized an alternative form of regulation for Ameritech Illinois ("Ameritech" or "AI") under a five year plan. This historic step, after over seventy years of rate-of-return regulation, was taken by the Commission because in its view the alternative

regulation plan promised to be a better regulatory structure to transform the local telecommunications market from a monopoly to a fully competitive market.

This conclusion was based on findings required by the Illinois Public Utilities Act (the "Act" or "Public Utilities Act"). By necessity, many of these findings rested upon the Commission's expectations regarding the pace of cost decreases and how Ameritech Illinois would respond to the incentives created by the alternative regulation plan. Chicago Ex. 1.0, p. 4. In this review, after six years of actual experience of the Plan, the Commission must reexamine its findings to determine whether the Plan has in fact, satisfied the policy goals and other requirements of the Illinois Public Utilities Act.

As the Order makes clear, the Commission's decision approving Ameritech's alternative regulation plan was made with reservation and its findings were not intended to remain forever unchanged. Indeed, the Commission expressed significant doubt about whether the benefits and goals of alternative regulation would, in fact, be realized and -- equally important-- whether consumers would be protected. 1994 Order, p. 20. Reduced to its simplest terms, the 1994 Order initiated an experiment--a trial-- that the Commission would watch very closely.

To address its concerns, the Commission added provisions to the Plan that it believed would: (a) reduce the risks inherent in an untested, new form of regulation; and (b) allow the Commission to actively track the plan's implementation and impacts. For example, the Commission ordered periodic reporting by Ameritech on service changes, the Company's earnings, and other financial and operational information. Also, the Commission put residential rates under a rate moratorium for the full term of the Plan to ensure that residential consumers would not be harmed by an experimental approach to assuring just and reasonable rates. 1994

Order, p. 64. (" In effect, the cap placed on Access and Band A services institutes a rate moratoria on rate increase for this customer class pursuant to Section 13-506.1(a)").

Finally, and most significantly, the Commission mandated a review of the five year Plan by a date certain so the Commission could evaluate the experiment on the basis of actual results to determine whether the alternative approach to regulation had worked and whether it should continue, with or without significant modifications, or be terminated.

The diverse elements of the approved plan show that the Commission did not adopt a "pure price cap plan." Instead, because of its reservations about alternative regulation, the Commission cautiously devised a combination of regulatory approaches: part price cap, part rate moratorium, and part rate-of-return. That combination allowed the Commission to test the effectiveness of the alternative regulation elements while preserving residential consumer protection and setting a standard for assessing the just and reasonable rate levels. Within this context, the Commission undertakes its review of the alternative regulation plan it authorized in 1994.

## ***2. Comprehensive and Detailed Analysis Required With Clearly Defined Standards of Review***

The Commission clearly contemplated, and the approval criteria of § 13-506.1(a) and (b) require, a comprehensive and detailed review of the alternative regulation plan. 220 ILCS § 5/13-506.1(a) and (b). To ensure a full evaluation of the plan's effectiveness, the 1994 Order identified ten issues for the Plan review proceeding.<sup>1</sup> Included among these ten is whether the

---

<sup>1</sup>The City of Chicago sponsored the testimony of one witness and cosponsored the testimony of four witnesses in this proceeding with the Attorney General, CUB, and Cook County. To avoid unnecessary duplication, the City limited its discussion of certain issues and incorporates by reference certain sections of the briefs of the cosponsors of the testimony in this

Plan has satisfied "each of the statutory and policy goals," a wide-ranging set of statutory requirements. Underscoring the Commission's uncertainty about the Plan's effects, the Commission did not limit its review to these ten issues. 1994 Order, p. 95. ("the application for review of the price cap mechanism shall address at least the following issues...") Finally, the Commission required Ameritech to initiate the review a full eighteen months prior to the anticipated end of the five year Plan period. *Setting aside eighteen months for review is a clear indication that the Commission intended this review to be thorough and detailed.*

Despite the experimental nature of the alternative regulation plan in Illinois, and the Commission's unequivocal intent that this review be comprehensive, Ameritech Illinois asserts this review is "relatively routine" and narrow in scope. See AI Ex. 1.1, p. 22; AI Ex. 1.3, p. 40. Ameritech inexplicably contends that there is no policy reason to conduct a full-scale analysis like the Commission performed in 1994 because the Plan is already in place. AI Ex. 1.1, p. 4.

Ameritech Illinois' recommended approach to this proceeding lacks any basis in fact, ignores the historical and practical significance of the Commission's 1994 Order, and violates the statutory requirements for alternative plan approval or continuation. Chicago Ex. 2.0, p. 3. Adopting Ameritech Illinois' approach to this review would neglect both the Commission's statutory duties and the interest of consumers.

Ameritech's position that this case is "relatively routine" is manifested throughout its testimony, but it is based entirely on a false syllogism. Unlike the Act and the Commission's decision, Ameritech assumes that because the Commission concluded in 1994 that its alternative regulation plan satisfied the statutory approval criteria of Section 5/13-506.1, then the Plan must

---

proceeding regarding the ten issues identified in the 1994 Order.

satisfy those criteria in all the ensuing years. Chicago Ex. 2.0, p.4. Accordingly, Ameritech Illinois makes no real attempt to provide empirical evidence that the Plan has satisfied the statutory requirements and goals.

Ameritech's stance is worse than illogical. It directly conflicts with the recognition of the possibility of an unsuccessful trial in both the Commission's 1994 Order and the Act. "[T]he application for review of the price cap mechanism shall address . . . whether, and the extent to which, the adopted regulatory framework has met each of the established statutory and regulatory goals." (emphasis added) 1994 Order, p. 95; Chicago Ex. 2.0, pp. 3-5.

Ameritech Illinois does not dispute that the Commission required that Ameritech address each of the ten issues identified in its 1994 Order. AI Ex. 1.1, Schedule 1. Ameritech Illinois argues that the Commission had only four policy goals for the Plan that all were satisfied by the Plan, and that, therefore, the Plan should be extended ("routinely") with only minor modifications. Ameritech Illinois' minor modifications, among other things, would -- incredibly -- lessen service quality penalties and allow it to increase noncompetitive rates even faster through "greater pricing flexibility".

Ameritech Illinois speculates from the 1994 Order that the Commission's only goals are the following:

- (1) provide price protection and benefits to customers of AI's noncompetitive services;
- (2) create an environment in which Ameritech Illinois would be incented to invest in its network;
- (3) establish a regulatory structure that would encourage Ameritech Illinois to operate efficiently and prepare itself for competition; and
- (4) allow Ameritech Illinois to address its capital recovery problems without increasing prices for noncompetitive service.



Al. Ex. 1.1, p. 10.

Even if the goals identified by Ameritech actually were the Commission's only goals (and they are not), the record demonstrates that the current Plan has not provided the desired consumer service, benefits, and protection. The failures stem from deficiencies in the Plan, as well as Ameritech's questionable operations under the Plan. Moreover, Ameritech, in its "routine" evaluation of the Plan, proposes to ignore both the factual context of the Commission's approval and post-approval evidence that warrants remedial action by the Commission.

First, Ameritech's customers are paying prices determined by the Plan formula, but are not receiving adequate levels of service that the Plan formula anticipated. In other words, even if the Commission assumes, *arguendo*, the validity of Ameritech's extremely questionable theory that prices produced by the Plan formula are *per se* just and reasonable, "routine" approval does not follow. Ameritech's dubious proposition is untenable, unless the Commission is prepared (contrary to the Act) to ignore completely the quality of service provided at the Plan formula prices.

Second, there is substantial evidence that Ameritech has abused the service reclassification process. By reclassifying services that did not meet the statutory criteria, Ameritech could increase rates for services that are actually noncompetitive above the level defined by the Plan index. Finally, Ameritech's "routine" evaluation of a plan of first impression would avoid any consideration of the effects of Ameritech's unique method of preparing for competition -- the unanticipated sale of the firm to a potential competitor.

**3. *Plan Results Must Be Compared To What Would Have Resulted From Rate Of Return Regulation***

The statutory criteria by which the Commission must evaluate alternative regulation plans are essentially comparative in nature. The statute specifically requires that any Plan approved by the Commission be a more appropriate form of regulation than rate-of return regulation based on the Commission's overall consideration of the policy goals in the statute. Chicago Ex. 2.0, pp.4, 6; see 220 ILCS 5/13-506.1(b)(4). As a result of this specific constraint on the Commission's approval authority, the Commission must determine whether and to what extent those same objectives could have been achieved, perhaps at a superior level, under rate-of-return regulation.

The City of Chicago supports the pro-competitive policies of the General Assembly and the Commission. Chicago Ex. 1.0, p. 5. However, the General Assembly has mandated a transition to competition that removes regulation only as effective competition develops. 220 ILCS 5/13-502. The availability of price constraining market forces is--prudently --an essential element of the foundation for approval of plans to reduce traditional regulation. Given the lack of competition in the local service market in Illinois, the Commission must determine expressly (on the record) whether consumers might well be better served by rate-of-return regulation, as opposed to an alternative form of regulation. Under the statutory criteria, traditional regulations certainly would be better than an alternative regulation plan that produces inadequate service quality to consumers at the same time it allows the company to earn profits at twice the level that could be earned under rate-of-return regulation.

**B. THE PLAN FAILED TO SATISFY KEY PUBLIC POLICY GOALS**

Section 13-506.1(b)(4) of the Pubic Utilities Act requires that the Commission find that

the alternative regulation plan is a more appropriate form of regulation based on the Commission's overall consideration of the policy goals of Section 13-103 and the policy goals of Section 13-506.1(a). 220 ILCS 13/506.1(b)(4).

*1. The Plan Failed To Satisfy The Policy Goal of Promoting Competition*

(a). Promoting Competition Is A Goal Of Alternative Regulation And Is Required By Statute

The City contends that one of the state's major policy goals -- promoting competition-- also echoed in the goals of the Commission's 1994 Order, has not been furthered, and most likely has been hindered, by the current alternative regulation plan.

All regulatory plans, including Ameritech Illinois' current alternative regulation plan, must adhere to the pro-competitive policy goals contained in Sections 5/13-102 and 5/13-103 of the Illinois Public Utilities Act. 220 ILCS 5/13-102, 103. In addition, Section 13-506.1(b)(4) specifically directs the Commission to consider the policy goals of Section 13-103 in determining whether the alternative regulation plan is a more appropriate form of regulation than rate-of return regulation. 220 ILCS 5/13-506.1(b)(4).

Section 5/13-102 states:

protection of the public interest requires changes in the regulation of telecommunications carriers and services to ensure, to the maximum feasible extent, the reasonable and timely development of effective competition in all telecommunications services markets.

and Section 13-103(b) states:

consistent with the protection of consumers of telecommunications services and the furtherance of other public interest goals, competition in all telecommunications services markets should be pursued as a substitute for regulation in determining the variety, quality and price of telecommunications services and that the economic burdens of regulation should be reduced to the

extent possible consistent with the furtherance of market competition and protection of the public interest.

(emphasis added)

It is critical that the Commission also note that furtherance of market competition and protection of the public interest are coequal objectives.

In the 1994 Order, the Commission found -- on the basis of the information then available -- that competition was likely to accelerate and that one of the purposes of the alternative regulation plan would be to provide a mechanism for a successful transition to a more competitive environment. 1994 Order, pp.19-20. Accordingly, the Commission found that the Plan would more effectively balance the interests of ratepayers, Ameritech, its shareholders and the overall interests of the people of the State of Illinois because of the changing structure of the local telecommunications market. *Id.*

Ameritech Illinois concedes that the promotion of competition is one of the Commission's major policy objectives. AI Ex. 1.3, p. 69. However, Ameritech takes the narrow, self-serving position that the Plan was designed only to prepare Ameritech Illinois for competition and not to promote market competition. AI Ex. 2.0, p.6. Therefore, Ameritech Illinois argues that the Commission should not consider the evidence of the Plan's effects over the last five years and need not concern itself with whether the Plan successfully promotes market competition. The Act, contrary to the Ameritech Illinois' argument, requires more.

As shown above, Ameritech's position directly conflicts with one of the Commission's major premises for adopting alternative regulation as well as the Commission's obligation as an evaluator-- on the evidence and under the statutory criteria. Moreover, it is simply illogical for

the Commission to authorize continuation of a Plan that does not provide a successful mechanism for a transition to competition. Clearly, a plan that actually and actively hinders the development of competition subverts a transition to competition.

(b) The Level of Effective Competition In Illinois Is De Minimis Under The Plan

By any meaningful measure, the level of competition in the local exchange services market is extremely limited. GCI Ex. 1.0, p. 20; Chicago Ex. 1.0, p.19. Despite this Commission's early leadership in promoting the development of competition and the Congress' passage of the Federal Telecommunications Act of 1996, the vast majority of residential customers and a substantial number of business customers still lack any meaningful ability to choose among local service providers today. Ameritech readily admits the reality -- impossible to deny -- that competition in the local residential market is minimal. AI Ex. 1.1., p. 47-48.

(1). *CLEC Market Share Remains Marginal*

The Commission has consistently found that market data are reliable and appropriate measures of the level of competition. GCI Ex. 11.0, p. 37. Accordingly, an examination of the number of resold lines and UNE loops being purchased by competitors compared to the total number of loops being provided by Ameritech is necessary and appropriate. Chicago Ex. 1.0, p. 23. Unlike other measures that are largely theoretical and attempt to show a level of competition that is potentially achievable, like the one Ameritech is asking the Commission to adopt in the instant case, market share analysis indicates the actual degree to which competitors are able to overcome the obstacles to entry and the strength of the market forces relied on to protect

consumers and the public interest. The evidence, in fact, shows competitors' ineffectiveness in competing with Ameritech and the absence of price constraining competition. GCI Ex. 11.0, p. 37.

The level of CLEC market share is practically nonexistent. Based on Ameritech Illinois latest data in the record, as of October 2000, only 3.38 % of residential and business lines are resold and only 2.99% of lines are provided on a UNE loop basis. Id. End-to-end facilities-based competition is even less significant. GCI Ex. 1.0, p. 23. Thus, after six years of alternative regulation that was supposed to promote competition, Ameritech's monopoly market share has decreased from approximately 100% only to about 93%. Moreover, as the Commission is well aware, competitive services using resold and UNE lines continue to provide Ameritech with revenue for the wholesale price of the line and the UNE loops. The stagnation of any growth of competition in the local market is especially apparent when it is compared to the rate of competitive growth in other telecommunications markets, like the long distance and CPE markets. Chicago Ex. 1.0, pp.18-21.

In addition, the prospects for future significant inroads by CLECs look difficult, at best. Investors have begun to look unfavorably on CLECs' abilities to succeed with business plans based on competing with recalcitrant ILECs like Ameritech Illinois. As of January 9, 2001, a broad index of CLEC stocks tracked by Morgan Stanley Dean Witter showed that CLEC stocks have decreased by 58.2% over the past 12 months. Chicago Ex. 2.0, p. 12.

(2). *Ameritech Has Failed to Open Its Network As Shown By Its Inability To Support a Section 271 Application*

A regional Bell telephone company must file a Section 271 application to request

approval to enter the interlata long distance market. To gain approval, the filing company must demonstrate that it has opened its network sufficiently under the Section 271 criteria of the Federal Telecommunications Act of 1996. It is undisputed that Ameritech Illinois has not filed a Section 271 application since 1996, strong evidence that even Ameritech does not believe that it has taken all of the steps necessary to open its network. Chicago Ex. 1.0, p. 27; Chicago Ex. 2.0, p.16.

Verizon-New York won Section 271 approval in January 2000. SBC, Ameritech Illinois' parent company, filed for Section 271 approval for the State of Texas in January 2000 and filed Section 271 applications for Kansas and Oklahoma in the fall of 2000. Chicago Ex. 2.0, p.15. Ameritech Illinois' comparatively slow progress demonstrates that the company has not been impelled to more aggressively open its network under the alternative regulation plan. During the Plan period, Ameritech Illinois was able to generate greatly increased profit under the Plan which the City contends is excessive, while service quality declined and competition stagnated.

(c). The Plan's Incentives Likely Have Hindered The Growth Of Competition

The Commission cannot ignore the perverse impact the Plan's incentives have had on the development of competition in the local market. Rather than serving as a mechanism for a successful transition to competition as contemplated by the Commission in its 1994 Order, it appears that the combination of the alternative regulation plans' financial incentives (principally uncapped earnings freedom), Ameritech Illinois' reaction to those incentives, and the ineffectiveness of consumer practices and service quality protections have acted to hinder the growth of effective price on service competition. GCI Ex. 1.0, p. 20; Chicago Ex. 2.0 pp. 9, 17.

The evidence, of necessity, is circumstantial, but, it is compelling. And, the Plan and its consequences are no less in need of correction.

The evidence of record shows that the level of competition in the local market is *de minimis*. It certainly is not at a level that, under the statutory criteria, can be determined to act as a substitute for regulation now or in the immediate future. The current alternative regulation plan allows Ameritech Illinois, the incumbent service provider, to retard competition with impunity, pay minimal fines for ignoring the quality of service to consumers, and still flow through to its shareholders 100% of what can only be described as excessive monopoly profits. GCI Ex. 1.0, pp. 25-26. Ameritech Illinois' ability to reclassify services as competitive and then immediately impose rate increases for newly "competitive" services demonstrates beyond reasonable dispute the absence of effective price constraining competition.

Ameritech Illinois' failure to open its network adequately, as evinced by its inability to support the filing of a Section 271 application, cannot be justified. Chicago 2.0, p. 15. As slim profit opportunities in the long distance market became apparent and, decreased the attractiveness of entering that market (GCI Ex. 1.0, pp. 25-26), Ameritech Illinois devoted its resources to attracting and closing a merger with a potential competitor. The "carrot" of the Telecommunications Act of 1996 and the alternative regulation plan's mechanisms were inadequate to prevent Ameritech Illinois' diversion of resources from building competition to buying protection from competition.

The Commission ignores this evidence at its peril, and to the detriment of Illinois consumers and the public interest. If the alternative regulation plan continues in the destination it seems to be headed in, the Commission will no longer have to worry about a transition to



competition. Instead, the Commission will only confront a deregulated monopoly -- one with a demonstrated disregard for customer service and an insatiable hunger for ever greater profits.

2. ***The Plan (And Ameritech's Rebalancing Petition) May Harm The Universal Service Goal Of The Public Utilities Act***

(a). The Plan May Have Harmed The Policy Goal of Universal Service

As stated previously, Section 13-506.1(b)(4) directs the Commission to consider the public policy goals of Section 13-301 when deciding whether to approve an alternative form of regulation. Section 13-301(a) states that it is the policy of the State of Illinois that:

(a) telecommunications services should be available to all Illinois citizens at just, reasonable, and affordable rates and that such services should be provided as widely and economically as possible in sufficient variety, quality, quantity and reliability to satisfy the public interest;

The record demonstrates that, at best, Ameritech has failed to meet its obligation to prove that the Plan promotes the universal service goal of Section 13-301. More reasonably, the evidence shows that there indeed may be a correlation between the alternative regulation plan's term and dropping penetration rates. Penetration rates in Illinois have fallen dramatically over the course of Ameritech's alternative regulation plan from 93.6% in 1995 to 91.8% in 1999. At the same time, the nationwide penetration rate actually increased from 93.9% in 1995 to 94.2% in 1999. Illinois currently has the seventh lowest percent penetration in the nation. GCI and City Ex. 8.0, pp. 6-8. A recent FCC Report identifies Illinois as the only state in the entire nation which has experienced a "significant decrease" in penetration rates. GCI and City 9.0, pp.1-2.

Mr. Gebhardt argues that Ameritech's residential basic exchange rates are not likely the cause of the penetration problem in Illinois, because Ameritech's local exchange rates are "generally low compared to those of incumbent LECs in other states as well as in Illinois." AI

Ex. 1.5, p. 3. However, an FCC survey of rates across 95 cities across the country shows that, for two out of the three Ameritech Illinois cities in the survey, Ameritech's rates including usage were higher than two-thirds of the other cities in the survey. GCI and City Ex. 8.0, p. 19. The fact is that many customers already have trouble paying their telephone bills at current Ameritech rates in Illinois. In 1999, Ameritech Illinois disconnected 187,847 customer accounts for nonpayment. Further, in 1999 Ameritech averaged 40,000 Lifeline customers in Illinois. GCI and City Ex. 8.0, pp. 8-9. These data demonstrate that tens of thousands of Ameritech's customers find it difficult to pay Ameritech's "generally low" rates.

(b). Ameritech's Rate Rebalancing Proposal Will Likely Further Harm Universal Service In Illinois

No party in this proceeding disputes the fact that declining telephone subscriber penetration rates is a serious issue in Illinois. In fact, as the Commission is well aware, the Staff of the Commission is working on this issue. A study has been commissioned by the ITA, UTAC, and Ameritech Illinois to determine the cause of this problem. AI Ex. 1.5, p. 3.

Based on this pending study, Ameritech Illinois argues that the Commission should wait until it understands the cause of the penetration problem before it tries to solve it. AI. Ex. 1.5, p. 3. It may be true that this proceeding does not have an adequate record to solve the problem. But, Ameritech's preference for caution on this issue -- consistently applied -- dictates also that the Commission should not risk making matters worse by approving Ameritech's rate rebalancing proposal. The Ameritech Illinois proposal could cause even more customers to drop off the network

Ameritech claims that its rate rebalancing proposal will not harm universal service, based

on a selective comparison of only two of its proposed rate changes. The claim flies in the face of a new customer's \$106 increase in recurring network access rates over the life of a new service order; the same customer would pay only \$28.55 less in non-recurring installation charges. GCI and City Ex. 8.0, p. 16. Existing customers would not even receive the \$28.55 reduction in new service installation charges. Similarly, GCI witness Dunkel's calculation of Ameritech's proposed Band B usage reduction shows that the proposed usage reduction would offset only 14% of the NAL increase. *Id.*

As shown above, it cannot be reasonably disputed that telephone bills for a sizable number of customers would go up under Ameritech's rate rebalancing proposal, which for many customers could mean the difference between staying on the network or paying other bills. In addition to all the other compelling reasons, the serious telephone penetration decline in Illinois would argue against adoption of Ameritech's proposal.

**3. *The Plan Has Failed To Satisfy Other Policy Goals Defined by the Act***

Ameritech failed even to attempt to show that the current alternative regulation plan satisfied key policy goals other than the four it chose to acknowledge. Ameritech chose not to provide the critical empirical evidence from the past six years that would show whether the Plan actually satisfied these goals. Instead, Ameritech argues that since the Commission expected that the Plan would satisfy its policy goals back in 1994, the Plan must have actually met those goals. Such faith in the Commission's inquiry is not evidence. And, to the extent that Ameritech-held performance data relevant to the Commission's assessment of the Plan's performance is absent from the record, the Commission must presume that it is adverse to Ameritech Illinois' position. In this regard, the City by reference incorporates the sections of the briefs of the Attorney

General, Cook County and CUB regarding the plan's failure to satisfy other policy goals of the Act.

C. THE PLAN FAILED TO SATISFY THE SECTION 13-506.1 STATUTORY REQUIREMENTS

Sections 5/13-506.1(a), (b) and (e) set forth explicit findings that the Commission is required to make in this review proceeding in order to extend the current alternative regulation plan, modify it, or return to rate-of- return regulation. The Commission based its findings in the 1994 Order on these statutory requirements when it first adopted an alternative regulation plan for Ameritech Illinois and expressly made them issues of the current review process in its 1994 Order. 1994 Order, p 196. The record demonstrates that the current alternative regulation plan fails to satisfy several of these requirements. The City will address two critical requirements in this brief. The City by reference incorporates the sections of the briefs of the Attorney General, Cook County and CUB regarding other statutory requirements.

Section 13-506.1(a) states in relevant part that:

In addition to the public policy goals declared in Section 13-103, the Commission shall consider, in determining the appropriateness of any alternative from of regulation, whether it will:

- (1) reduce regulatory delay and costs over time;
- (2) encourage innovation in services;
- (3) promote efficiency;
- (4) facilitate the broad dissemination of technical improvements to all classes of ratepayers;
- (5) enhance economic development of the State; and
- (6) provide for fair, just and reasonable rates.

Section 5/13-506.1(b) requires that:

The Commission may approve the plan or modified plan and authorize its implementation only if it finds, after notice and hearing, that the plan or modified

plan at a minimum:

- (1) is in the public interest;
- (2) will produce fair, just and reasonable rates for telecommunications services;
- (3) responds to changes in technology and the structure of the telecommunications industry that are, in fact, occurring;
- (4) constitutes a more appropriate form of regulation based upon the Commission's overall consideration of the policy goals set forth in Section 13-103 and this Section;
- (5) specifically identifies how ratepayers will benefit from any efficiency gains, cost savings arising out of the regulatory change, and improvements in productivity due to technological change;
- (6) will maintain the quality and availability of telecommunications services; and
- (7) will not unduly or unreasonably prejudice or disadvantage any particular class, including telecommunications carriers.

Section 5/13-506.1(e) in relevant part states that:

Upon petition by the telecommunications carrier or any other person or upon its own motion, the Commission may rescind its approval of an alternative form of regulation if, after notice and hearing, it finds that the conditions set forth in subsection (b) of this Section can no longer be satisfied.

***1. The Current Plan Has Produced Inadequate Service Quality***

In the 1994 Order, the Commission adopted a service quality component in the price cap formula. 1994 Order, p. 58. The Commission's action expressly recognized the risk that Ameritech Illinois, in its efforts to maximize its income under the Plan, would have powerful economic incentives to reduce expenditures for reliability and service quality. *Id.* Accordingly, the Commission adopted eight quality of service measures suggested by Ameritech Illinois and used the company's 1990 and 1991 actual results as performance benchmarks. *Id.* The Commission concluded that a service quality component as part of the formula was necessary to moderate the incentive to allow service quality to deteriorate where that action yielded greater

profits. Id. This requirement also served to address the requirements of Section 13-506.1(b)(6) of the Public Utilities Act that any alternative regulation plan "maintain the quality and availability of telecommunications services". Id.

The City, GCI and the Staff of the Commission each have concluded that the quality of service seriously deteriorated under the Plan. Ameritech Illinois' performance data under alternative regulation-- evidence that is part of this record -- demonstrate that despite the inclusion of penalties that reduce Ameritech Illinois' noncompetitive rates for violations of the various service quality standards, the Plan's generous rewards and weak punishments were ineffective in maintaining service quality. GCI and City Ex. 2.1 (Compilation of available service quality performance data).

The Commission also should not limit its focus to the eight service quality measures ordered in the 1994 Order because that would not give the Commission a full and accurate illustration of the decline in service quality under alternative regulation. GCI and City Ex. 12.0, p. 10. Indeed, service quality has declined in other important areas. Id. One of the primary reasons for the service decline in other areas not currently measured as part of the Plan appears to be Ameritech's reallocation of its repair efforts from service repairs (Other Repairs) not measured by the current Plan to service repairs that are measured as part of the Plan. GCI and City Ex. 12.0, p. 13. While the Other Repair intervals of other Bell Operating Companies have remained relatively steady on average, the Other Repair intervals experienced by Ameritech customers in Illinois have increased dramatically. Id.

Ameritech's service quality decline also appears to be related to its lack of maintenance and capacity in outside plant, as discussed by SBC Chief Executive Officer Whitacre to stock

market analysts in December 2000. GCI and City Ex. 12.0, p. 14. In fact, an examination of Ameritech's investment history shows a declining investment in outside plant. *Id.* Ameritech Illinois' annual new investment in outside plant declined from approximately \$35 per access line in the 1990-1991 time frame before alternative regulation to about \$19 per access line in 1999, the fifth year under the Plan. *Id.* (The City recommends increased investment in outside plant to the 1996 level of \$29 per access line, at a minimum).

A review of the decision-making processes of Ameritech Illinois' management on service quality issues does not bode well for customers, perhaps under any form of alternative regulation for Ameritech. The Commission may have to rethink the efficacy of a carrot-or-stick approach. Despite statutory mandates for adequate service and maintenance of quality, Ameritech Illinois repeatedly has coldly calculated the excess of profit over penalty and sacrificed its customers and quality of service to its own self-interest.

Under the Act, the Commission must consider a return to rate-of-return regulation. Commissions elsewhere have done so when service quality deterioration has warranted it. Indeed, under the Public Utilities Act, it is alternative regulation that requires special approval. rate-of- return regulation is the statutory default. Alternative regulation can continue only if it is proved to be superior.

(a). OOS > 24 Hours And Installation Within Five Days Are The Most Important Service Quality Standards Of Current Plan.

The OOS > 24 hours and the Installation within five days service quality measures both measure the amount of time it requires Ameritech Illinois to provide telecommunications service to the consumer. In the case of the OOS > 24 hours standard, it is a measure of the time it takes

Ameritech Illinois to restore service once a customer is out of service. Ameritech is supposed to restore service 95% of the time within 24 hours. The installation within five days standard measures the time it takes Ameritech Illinois to provide service to a new customer once the customer places an order.

Common sense dictates that if a customer cannot obtain telecommunications service because service is suffering an outage or it cannot be installed initially, no other component or measure of service quality has any practical significance for that customer. To a customer who cannot get service, it doesn't matter whether dial tone could be provided immediately (if he had service) or whether a call to a customer service office could be answered within a certain number of seconds (if he had service to discuss). Similarly, it doesn't matter to that customer if any new services have been recently introduced or whether rates have been reduced for customers who have service. To consumers, OOS >24 hours and installation within five days are the most important service quality measures in the current (and any future) plan. Ameritech Illinois' failure to meet these two threshold standards colors its entire service quality performance under the Plan and should be properly of utmost concern to the Commission. Even perfect performance in all other service measurements cannot outweigh Ameritech Illinois' gross failures in these areas. <sup>2</sup>

Ameritech Illinois argues that nothing in Section 13-506.1 of the Public Utilities Act elevates the OOS > 24 hours standard to primary importance. Logic and the Commission's common sense are adequate for that prioritization. Moreover, Ameritech Illinois' calculated

---

<sup>2</sup>The City notes that Ameritech Illinois' recent improvement in these areas is directly attributable to the Commission's active oversight (which Ameritech Illinois would decrease), not to the regularly ignored penalties of the alternative regulation plan or the statutory mandates.



subordination of the aspect of service most critical to customers is the best possible proof to the Commission that Ameritech Illinois still retains market power and knows it. AI Ex. 1.3, p. 13. In a competitive market, where the customer has a meaningful choice of providers, winning that consumer's business by initiating and restoring service would be priority number one. Yet, Ameritech Illinois blithely makes consumers wait for the chance to be an Ameritech Illinois customer or to be able to use the services they have chosen. Most consumers (especially residents) have no real alternative.

(b). Service Quality Performance Has Grown Worse, Not Better Over the Life Of The Plan

No party disputes the fact that scores of Ameritech Illinois' customers waited weeks for their telecommunications service to be restored and weeks, or even months, for telephone service to be installed during the year 2000, the last full year of the current plan. GCI and City Ex. 2.0, pp.10-11. This is unprecedented in Ameritech Illinois' modern history.<sup>3</sup> It was inconceivable under rate-of-return regulation. The serious decline in providing service is summarized by the following:

- The rate of failure in correcting out of service situations within 24 hours averaged about 14.1% between 1995-1998—over twice the average rate of failure in 1990-1994. GCI and City Ex. 2.0, p. 10; GCI and City Ex. 2.1-2.5;
- OOS>24 hours performance reached 15.2% in August 2000. Id.

---

<sup>3</sup> The Commission's Consumer Services Division has received a significant increase in customer complaints. Chicago Ex. 1.0, p. 60. Complaints against Ameritech grew from 1995 through November, 2000, the last month for which data is available. Staff Ex. 9.0, pp. 7-12. In 1995, the first year of the Plan, the Commission received fourteen complaints from Ameritech customers regarding unsatisfactory performance of "scheduling or repair," and twenty complaints regarding unsatisfactory installation service. Id. at 10. By 2000, those complaints had grown to six hundred forty nine and nine hundred ninety two, respectively.

- For the month of September 2000, Ameritech reported an OOS>24 hours rate of 37%, more than seven times the allowed rate per 83 Ill. Admin. Code Part 730, the Commission's service quality rules, and the existing Plan. Id.
- The number of lines that were out of service almost doubled between late 1999 and mid-2000. Id.
- Since early 1999, the average number of days needed to install a new access line (as captured by the POTS Mean Installation Interval measure) has more than doubled for residential customers. Id.

The fact that this worsening of poor service occurred near the end of the plan should be of particular concern to the Commission. First, under an effective plan it would be reasonable to expect the company's performance to get better over time, not worse. Ameritech Illinois' alternative regulation plan evidently has been unsuccessful in fostering efficient and cost-effective processes to provide quality service, despite the fact that it has been operating for five years. Second, the Commission Staff and Ameritech Illinois have been meeting monthly since the fall of 1998 to address service quality issues, with no apparent success in resolving the underlying causes of Ameritech Illinois' service quality problems. Chicago Ex. 1.0, p. 59.

In addition, the increased Staff and Commission oversight uncovered the fact that Ameritech Illinois has routinely included vertical services in its installation data when reporting whether it satisfied the benchmark for all installations of new service. Staff Ex. 7.0 p. 7. The addition of vertical services, like call forwarding and call waiting, almost never requires an on-site visit to the customer's residence to install the service. Tr. 1814-1815. It merely requires a data entry into a computer. Id. Accordingly, including the installation times for vertical services will yield a misleading, lower average time for all installations. The record evidence shows that, without including vertical services in this data, Ameritech would have failed to meet the

Installation within five days standard throughout the life of the Plan. Staff Ex.8.0, p. 10. No other local exchange carrier contacted by GCI or the Staff calculates the measure in this manner. Staff Ex. 8.0, p. 9; GCI and City Ex. 2.0, p. 27. Again, close Commission oversight, not the Plan's various carrots or sticks, produced this cleaner view of real customer service levels.

While Ameritech Illinois acknowledges that OOS > 24 hours seriously deteriorated during the July- October 2000 time frame, Ameritech Illinois offers numerous reasons why the Plan should not be held accountable. First, Ameritech Illinois claims that because the Commission addressed OOS > 24 hours problems in the merger case and increased the penalty for violations there, it is not an issue in this proceeding. AI Ex. 1.1, p. 41. The Commission, however, never expressly acknowledged in its merger order that this issue could not be addressed in this proceeding. More important is the fact that the company failed to meet this standard after the merger, even with the substantially increased penalty. The Commission must now consider what it will take to get Ameritech Illinois to provide quality service, and whether alternative regulation penalties can ever overcome the prospect of higher profits achieved by reduction of expenses needed to maintain quality of service.

Ameritech's second--and even more frivolous-- defense is that the serious service decline in the year 2000 is technically beyond the five years of the Plan, and therefore, the Commission should ignore it for purposes of this review. AI Ex. 1.3, p. 15. Even assuming that Ameritech Illinois intends this to be a serious defense, the record discloses that Ameritech was aware of its serious problems for some time and had been meeting with Staff for years during the Plan to try to resolve the out of service problems. Staff Ex. 8.0, pp. 5-6. Ameritech Illinois has again demonstrated that the alternative regulation plan was inadequate to correct the problems in a

timely fashion.

Ameritech Illinois' next defense is that the failure to meet the OOS > 24 hours standard does not mean that the Plan operated improperly or that the Plan created improper incentives. After all, Ameritech argues, it had trouble meeting this standard under rate-of-return regulation. AI Ex. 1.1, pp. 40, 84. That Ameritech has failed to meet this standard under both forms of regulation does not support Ameritech claims that the Plan was successful. The burden is on Ameritech to show that the Plan satisfied the statute, including the criteria that it maintained service quality; it is not the City's burden to show that it did not. What Ameritech Illinois' argument actually illustrates is the importance of active Commission oversight and remedial action - - under any regulatory regime.

In addition, economics literature and this Commission have recognized that alternative regulation plans provide greater incentives to provide poor service quality than rate-of-return regulation because of the increased ability to maximize earnings. GCI and City Ex. 12.0, p. 16. Indeed, a comparison to Verizon, the major rate-of-return regulated company in Illinois, shows that Ameritech Illinois' service performance is much worse for all repair related measures. Id.

(c). Ameritech Illinois' Current Plan Permits A Self-Serving Cost-Benefit Analysis And Does Not Support Service Quality

The Commission's worst fear --that Ameritech would allow service quality to degrade so that it could convert the resulting cost savings into additional uncapped and unshared profits-- has come to pass. 1994 Order, p.58. On the evidence it is not a question of whether Ameritech Illinois has the capacity to provide quality service. It does. Ameritech met the OOS > 24 hours standard in 1999. The question is what incentives--inside or outside the Plan--can be devised to

provide high quality service consistently, even if it lowers profits.

It has become clear that Ameritech's approach to service quality begins with a cost-benefit analysis that translates the issue into one of dollars and cents, not how the company can satisfy its statutory duty or meet customers' needs. This fact became all too evident in the merger case. There, Ameritech Vice President Gebhardt acknowledged that it was less costly to absorb the penalty for failing to achieve the OOS > 24 hours standard than to spend the funds necessary to fix the problem. Chicago Ex. 1.0, p. 63.

This corporate mind-set apparently continues under the new SBC/Ameritech Illinois management. Despite the fact that the Commission's merger order provided an additional penalty of \$30 million for violation of the OOS > 24 hours standard, Ameritech failed to meet the standard. The Commission can reasonably conclude that even a \$30 million penalty is an insufficient incentive to assure quality service for a company with a parent with approximately \$56 billion in annual revenue.

Recently, Ameritech Illinois finally started to respond and spend some of the money necessary to address its service quality problems, but only after its service quality degraded to the point where the Chairman of the Commission (and the chairman of the other five Ameritech states) intensified their oversight activities and publicly applied pressure on the Company. Chicago Ex. 1.0, p. 61. After the regulators' highly publicized and aggressive oversight, Ameritech Illinois finally decided to use resources from earnings and other subsidiaries in Illinois. In its October 20, 2000 service quality progress report, Ameritech Illinois claimed that it reduced its backlog of orders for installation and repair by 35% over a four-week period. Id. Clearly, Ameritech Illinois had – but chose not to deploy – adequate resources and technical

ability to support the maintenance of service quality. If the question is why Ameritech didn't use these resources earlier to avoid a service quality crisis, the answer seems to be that the Plan incentives, even the higher penalties adopted in the merger docket, were insufficient to tip the scales in favor of service instead of profit.

## **2. *The Plan Has Produced Unjust and Unreasonable Rates***

Section 13-506.1(b)(2) requires that an alternative regulation plan "produce fair, just, and reasonable rates for telecommunications services," and Section 13-103(a) requires that rates be "just, reasonable and affordable." 220 ILCS 5/13-506.1(b)(2), 5/13-103(a).

The record demonstrates that Ameritech Illinois' current rates are unjust and unreasonable, in part, because the 4.3% X factor that the Commission adopted in the 1994 Order was set too low. GCI and City Ex. 3.0, P. 15-16. As a result, the Plan rates produced earnings well in excess of the rate-of-return that the Commission would authorize and which would be expected to arise in an effectively competitive market. Chicago Ex. 1.0, p. 43. Similarly, the amount by which noncompetitive rates were lowered under the Plan was also insufficient, due to the inadequate "X" factor. This ineffective price/earnings constraint, coupled with Ameritech Illinois' dubious reclassification of services (followed by price increases), allowed Ameritech Illinois to achieve a net return on investment in 1999 of 28.49% for intrastate operations and 43.08% return on equity. GCI and City Ex. 6.2, p. 3.

### **(a). Noncompetitive Rates Set By Price Cap Formula**

In the 1994 Order, the Commission adopted a price cap formula that the company has used to set rates for noncompetitive services during the operation of the alternative regulation plan. Contained in the price cap formula was a productivity offset, or "X" factor, that was

designed to fully capture the actual extent of Ameritech Illinois' productivity growth over the life of the Plan. In the 1994 Order, the Commission set the "X" factor at 4.3%.

Ameritech argues that as long as Ameritech properly implemented the Plan, the resulting noncompetitive rate levels must be presumed to be just and reasonable because the going-in rate levels were found to be just and reasonable. AI Ex. 1.1, p. 70. However, annual reductions of rates under the plan from applying an experimental mathematical calculation (the plan formula) do not establish that rates are just and reasonable, or constitute a finding by the Commission that the rates are just and reasonable. For instance, if costs decreased or productivity increased to a greater extent than reflected in the plan formula, rates may no longer be "just and reasonable" as required by the Illinois Public Utilities Act. Chicago Ex. 1.0, p. 39. The record evidence supports this finding. Id.

(b). Competitive Rates Also Must Be Just and Reasonable

During the Plan period, Ameritech Illinois, without Commission action, could reclassify a noncompetitive service as competitive, thereby removing that service's rates from the application of the price cap formula. 220 ILCS 5/13-502. However, the reclassification of a service as competitive did not relieve Ameritech Illinois from providing that service at just and reasonable rates. Chicago Ex. 1.0, p. 44. Consumers of local telephone service purchase competitive as well as noncompetitive services from Ameritech Illinois, and both types of service contribute to their total bill. The Public Utilities Act does not exempt such Ameritech Illinois services from the Act's requirement that rates be just and reasonable. The classification simply reflects an expectation that the reclassification criteria would assure such a presence of effective, price-constraining competition that the need for even formulaic price adjustments is obviated.